Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of: À La Carte and Themed Tier Programming and Pricing Options for Programming Distribution on Cable Television and Direct Broadcast Satellite Systems	 MB Docket No. 04-207

REPLY COMMENTS OF VIACOM

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SUMMARY

The vast majority of commenters to this proceeding overwhelmingly confirm that an à la carte or themed tiering mandate is unnecessary and, in fact, would be highly detrimental to the public interest. Parties representing a full range of interests—from independent and vertically integrated programmers, to MVPDs of all sizes, to public interest organizations, to federal, state, and local government representatives—demonstrate that any requirement to carry program services on an à la carte basis would dramatically raise costs for consumers at the same time that it would decrease both the quality and the variety of services available to them. Notably, a number of parties representing specialized and minority interests—the alleged beneficiaries of an à la carte regime—stress that an à la carte system would directly and substantially threaten the viability of niche-oriented program services.

Even those few parties advocating some form of regulation emphasize the negative consequences of mandating the provision of à la carte services to consumers and vehemently argue that they themselves should not be subject to any form of regulation. Instead, these parties seek to impose a broad array of regulations on programmers that would give distributors the "flexibility" to provide à la carte services. These requests for so-called "voluntary" à la carte are misleading. The regulations suggested by these parties would not be "voluntary" at all for programmers. In any case, these same parties have supplied a long list of reasons why the provision of per-channel services to subscribers would have dire consequences for their business models and ultimately would harm consumers.

The suggestion of a few parties that an à la carte option would save consumers from being forced to pay a "tax" for unwanted program services misses the mark entirely. As has clearly been demonstrated in this proceeding, the current program distribution system is highly

efficient for all consumers. The distribution of crayons in multi-color boxes illustrates the point. By combining popular and a range of more specialized colors into a single box, crayon distributors make the entire package more appealing for consumers as a whole—even though individual consumers inevitably will not have a use for some of the colors in each box. The arrangement also reduces the costs that would be associated with distributing individually packaged crayons. In this manner, the vast majority of consumers are able to receive the colors they do want at a relatively low cost. The distribution of program services in packages is efficient for consumers in essentially the same way.

A handful of parties call for a series of intrusive constraints on the marketplace negotiations for retransmission consent. In particular, this small minority of distributors claims that requiring carriage of new networks in exchange for retransmission consent is anticompetitive. In fact, the practice of exchanging carriage of affiliated program services for retransmission consent is a longstanding one in the video programming industry that was initiated at the behest of MVPDs. At the time, cable operators found that providing distribution for new networks could provide television broadcasters with value for their signals at lower cost than cash compensation. Moreover, the FCC repeatedly has endorsed this practice as "consistent with competitive marketplace considerations."

Antitrust analysis does not suggest otherwise. With hundreds of cable networks up and operating in today's marketplace, it is clear that the cable programming market is strong, vibrant, and competitive and that the adverse effect on competition prohibited by the antitrust laws simply does not exist. Accordingly, there is absolutely no need to eradicate the careful balance that Congress and the Commission have struck in crafting the existing retransmission consent policies.

In addition to their requests to essentially repeal the retransmission consent rules, several parties ask the FCC to further weaken broadcasters' rights to negotiate for carriage of their local signals by reciting their time-worn requests to expand the program access rules to non-vertically integrated programmers, including broadcasters. Again, these parties show no competitive basis for such far-reaching changes to this regulatory scheme, which was designed only to address potential problems created by the vertical integration of cable operators and programmers.

In sum, based on the great weight of the evidence in this proceeding, Viacom respectfully submits that the Commission recommend to Congress that the creation of mandatory à la carte regulations, at either the wholesale or retail level, would be unnecessary and highly counterproductive for consumers.

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REPLY COMMENTS OF VIACOM

I. THE WEIGHT OF THE EVIDENCE IN THIS PROCEEDING CONFIRMS THAT THERE IS NO BASIS FOR AN À LA CARTE OR THEMED TIERING MANDATE

The vast majority of commenters to this proceeding have stated that regulations imposing à la carte or themed tiering requirements would have adverse consequences for all segments of the video programming industry and, ultimately, for consumers. Tellingly, even those few parties advocating some form of regulation point out the negative consequences of mandating the provision of à la carte services to consumers and vehemently argue that they themselves should not be subject to any form of regulation. What these parties ask for, instead, is the imposition of a series of onerous regulations on programmers that would give distributors the "flexibility" to provide à la carte services that many apparently have no intention of offering to consumers and that simply would transfer value from programmers to MVPDs. As explained herein, the suggestion that the FCC recommend regulations enabling a so-called "voluntary" à la carte system is both disingenuous and devoid of factual and economic support.

A. Commenters Representing A Full Range Of Interests Overwhelmingly Agree That Such Regulation Would Be Detrimental To The Public Interest

Independent and vertically integrated programmers, multichannel video programming distributors ("MVPDs") of all sizes, public interest organizations, government officials, and individual consumers alike recognize the inherent benefits in the current system of program packaging and distribution and acknowledge that an à la carte or themed tiering mandate would significantly and needlessly threaten this well-functioning system to the detriment of consumers. The large array of network programmers that have weighed in on this proceeding almost universally agree that bundling services into tiers has enabled an incredible diversity of program services to launch and thrive. By contrast, an à la carte regime would undermine the ability of these services to garner the viewership, subscription revenues, and advertising revenue needed to remain viable.[1] Many of these programmers further point out that, under an à la carte or themed tier regime, their marketing expenses would skyrocket as they begin to incur the huge costs

[1] *See* A&E Television Networks Comments at iii-v; Bloomberg Television Comments at 2-3 ("Bloomberg Comments"); Courtroom Television Network LLC Comments at iii-v; C-SPAN Networks Comments at 1-5 ("C-SPAN Comments"); Discovery Communications, Inc. Comments at iii-v ("Discovery Comments"); Eternal Word Television Networks, Inc. Comments at 2-6 ("Eternal Word Comments"); Fox Cable Networks Group Comments at i-iv ("Fox Cable Comments"); GSN—The Network for Games Comments at 2-8 ("GSN Comments"); Hallmark Channel Comments at 2-12; International Cable Channels Partnership, Ltd. Comments at 1 ("International Networks Comments"); Joint Commenters—Altitude Sports & Entertainment, *et al.* Comments at i-v ("Altitude Sports Comments"); LAtv Holdings, LLC Comments at 1-2 ("LAtv Comments"); LeSEA Broadcasting Corporation, Inc., *et al*. Comments at 4-7 ("LeSEA Comments"); Lifetime Entertainment Services Comments at 3-8; MBC Gospel Network LLC Comments at 1-9 ("MBC Network Comments"); NBC Universal, Inc. Comments at 1-8; Oxygen Media Corporation Comments at 2-8 ("Oxygen Comments"); Scripps Networks, Inc. Comments at 1-5; Starz Encore Group LLC Comments at 2-6 ("Starz Comments"); TelAlaska, Inc. Comments at 2-3; Turner Broadcasting System, Inc. Comments at 1-2; TV One Comments at 1-3; Univision Communications Inc. Comments at i ("Univision Comments"); Viacom Comments at 1-3; Walt Disney Company Comments at 2-3 ("Disney Comments"); and Weather Channel, Inc. Comments at 1-2. (Unless indicated otherwise, all comments cited herein were submitted in MB Docket No. 04-207 on July 15, 2004.)

inherent in broad-scale direct-to-consumer retail sales.[2] Detailed economic analyses consistently demonstrate that, in the end, consumers would face sharp price increases as well as a considerable drop in program diversity and quality.[3] Importantly, these concerns are voiced not only by the most widely viewed networks, but also by a broad range of independent, niche, religious, and minority-oriented programmers.[4]

Both large-scale and smaller MVPDs note that under the present system they have strong incentives to deliver appealing services to consumers in the most efficient manner possible.[5] In particular, MVPDs point out that à la carte requirements would be fraught with technical challenges and would entail substantial marketing, billing, and other operational expenses that would drive up consumer costs considerably.[6] Moreover, even MVPD proponents of some form of regulation, such as EchoStar and the American Cable Association, recognize that mandating the provision of à la carte services to subscribers would needlessly hinder their business operations and have negative consequences for consumers.[7]

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[2] *See, e.g.*, Bloomberg Comments at 10-11; C-SPAN Comments at 4-5; GSN Comments at 7-8; Hallmark Channel Comments at 7-8; Altitude Sports Comments at 56-58; Oxygen Media Comments at 6; Starz Comments at 2-6; TV One Comments at 2; Disney Comments at 2, 18.

[3] *See* Comcast Corporation Comments, Appendix A ("Comcast Comments"); Insight Communications Company, Inc. Comments, Exhibit B ("Insight Comments"); National Cable & Telecommunications Association Comments, Exhibit A ("NCTA Comments"); Discovery Comments, Exhibit A; Disney Comments, Exhibits 1, 2; Fox Cable Comments, Appendix A; Viacom Comments, Attachment 1.

[4] *See, e.g.*, LAtv Comments at 2-8; Univision Comments at 9-17; MBC Network Comments at 4-9; TV One Comments at 1-3; International Networks Comments at 5-9; Eternal Word Comments at 2-6; LeSEA Comments at 4-7; Oxygen Comments; Scripps Networks Comments at 16-22.

[5] *See* Advance/Newhouse Communications Comments at 1-3; Charter Communications, Inc. Comments at i-ii; Time Warner Cable Inc. Comments at 1-2 ("Time Warner Comments"); Comcast Comments at i-ii; NCTA Comments at 4-5.

[6] *See, e.g.*, The DIRECTV Group, Inc. Comments at 5-8; Smaller Operators Comments at 5-10; Insight Comments at 4-22; NCTA Comments at 27-28; Time Warner Comments at 8-9.

[7] *See* EchoStar Satellite LLC Comments at 1, 3-4 ("EchoStar Comments"); American Cable Association Comments at 6-7 ("ACA Comments"); Broadband Service Providers Association Comments at 10 ("BSPA

A wide assortment of public interest organizations, private citizens, and federal, state, and local government representatives raise similar objections. Notably, several public interest groups representing minority interests express concern that à la carte or themed tiering obligations would pose a substantial threat to the creation and success of niche services, particularly to those services operating independently and representing minority viewpoints.[8] In addition, dozens of elected officials have written letters to Congress and the Commission detailing the adverse consequences that an à la carte mandate would have on diversity and consumers, generally concluding that such obligations would be a "classic case of a solution that is far worse than any perceived problem."[9] Finally, despite the facial appeal of being able to select networks on a per-channel basis, individual consumers recognize the disadvantages that an à la carte mandate

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Comments"); CT Communications Network, Inc. Comments, *et al.* at 12-13 ("CT Communications Comments"); Discovery Comments at 4-21.

8 *See, e.g.*, The American Center for Law and Justice Comments at 9-13; Leadership Conference on Civil Rights Comments at 3-7; *see also* Letter from Dr. E. DeLores Tucker, National Chair, National Congress of Black Women, to Marlene H. Dortch, Secretary, FCC (June 28, 2004); Letter from Lorraine Cortes-Vazquez, President, Hispanic Federation, to Michael K. Powell, Chairman, FCC (June 30, 2004); Letter from Antonio Gonzalez, President, William C. Velasquez Institute, to Michael K. Powell, Chairman, FCC (July 1, 2004); Letter from Marc H. Morial, President & CEO, National Urban League, to Marlene H. Dortch, Secretary, FCC (July 7, 2004); Letter from Gabriela Lemus, Director of Policy and Legislation, League of United Latin American Citizens, to Michael K. Powell, Chairman, FCC (July 7, 2004); Letter from Rev. Wille Barrow, Rainbow/PUSH Coalition, to Marlene H. Dortch, Secretary, FCC (July 9, 2004); Letter from Alvin Brown, Chairman, National Black MBA Association, to Marlene H. Dortch, Secretary, FCC (July 9, 2004); Letter from Guarione M. Diaz, President, Cuban American National Council, to Michael K. Powell, Chairman, FCC (July 14, 2004); Comments of The Women's Alliance (July 20, 2004); Comments of New York Women in Film and Television (July 22, 2004); Comments of The American Business Women's Association (July 23, 2004).

9 *See* Letter from Harvey C. Johnson, Mayor, Jackson, Mississippi, to Joe Barton and John Dingell, U.S. House of Representatives (July 12, 2004); Letter from Roosevelt F. Dorn, Mayor, Inglewood, California, to Joe Barton and John Dingell, U.S. House of Representatives (July 12, 2004); Letter from Irene H. Brodie, Mayor, Robbins, Illinois, to Joe Barton and John Dingell, U.S. House of Representatives (July 12, 2004); *see also* Letter from Linda T. Sanchez, U.S. House of Representatives, to Michael K. Powell, Chairman, FCC (June 30, 2004); Letter from Congressman Raul M. Grijalva, U.S. House of Representatives, to Michael K. Powell, Chairman, FCC (July 12, 2004); Letter from Representative Steve Gallardo, Arizona House of Representatives, to Michael K. Powell, Chairman, FCC (July 2, 2004); Letter from Dannel P. Malloy, Mayor, Stamford, Connecticut, to Michael K. Powell, Chairman, FCC (July 6, 2004); Letter from Mayor Douglas Palmer, National Conference of Democratic Mayors, to Marlene H. Dortch, Secretary, FCC (July 8, 2004); Letter from Leroy Comrie, Council Member, City of New York, New York, to Michael K. Powell, Chairman, FCC (July 15, 2004).

would have in comparison to their current service packages in terms of price, quality, and diversity.[10]

B. Demands For A So-Called "Voluntary" À La Carte System Are Misleading And, In Any Case, Would Be Manifestly Contrary To The Public Interest

While opposition to a mandatory à la carte regime is almost universal, some commenters propose a so-called "voluntary" system, in which MVPDs would have the option of selling program services on an individual basis.[11] The great weight of the evidence in this proceeding, however, flatly refutes the unsupported assertions by these parties that such a system would in any sense serve the interests of consumers.

Most fundamentally, this allegedly "voluntary" system, in fact, would not be voluntary at all for programmers. As proponents of the system acknowledge, the government would be called upon to interfere with existing contracts between programmers and distributors, impose severe restrictions on how networks sell their services, and regulate the details of the prices, terms and conditions of program sales.[12]

The so-called "voluntary" à la carte system also would suffer from the same fundamental problems as mandatory à la carte. In addition to the costs imposed by new regulatory burdens, the cost of marketing programming would increase dramatically, and subscription fees and advertising rates would drop, due to the decline in subscribership. Consequently, consumers

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10 *See, e.g.*, Andrea Plummer Comments (July 7, 2004); Sallie Jackson-Asghar Comments (July 7, 2004); William R. King Comments (July 15, 2004).

11 Such a regime, these commenters assert, would provide consumers with more choice, *see* ACA Comments at 6; enable subscribers to avoid paying for services that they find undesirable, *see* Consumers Union and Consumer Federation of America Comments ("CU/CFA Comments"), The America Channel Comments at 1, BSPA Comments at 11, CT Communications Comments at 4; promote the development of new independent programming, *see* BSPA Comments at 12-13, CT Communications Comments at 15-17; and better serve the needs of networks and advertisers, *see* BSPA Comments at 13.

12 BSPA Comments at 15-16.

would confront higher rates and, perhaps most critically, a decline in the quality and diversity of program offerings. Even the alleged beneficiaries of à la carte—independent programmers—make abundantly clear that the inability to ensure carriage is the greatest obstacle to launching and sustaining a new service.[13] In addition, ACA and several other parties voiced opposition to *mandatory* à la carte due to the huge costs MVPDs would incur to install the technology necessary to make per-channel selections possible.[14] Yet, these same substantial technology costs would be incurred in the implementation of a "voluntary" à la carte regime, and those costs undoubtedly would be passed on to consumers. In essence, these operators are seeking the right to make their existing obligations to programmers optional, without giving programmers anything in return for this increased flexibility and without any obligation to pass additional options on to consumers.

Moreover, claims that providing an à la carte option would enable consumers to avoid paying for services that they do not want simply are off base.[15] As Economists Incorporated ("EI") explains in the attached response, consumers pay not for unwanted channels, but for a

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13 *See infra* Section I(A). In obvious recognition of this serious impediment to new program development, one *proponent* of à la carte ironically seeks a multi-year "grace period" from à la carte treatment for start-up services, because consumers are so unlikely to subscribe to new networks that are sold on an individual basis. *See* The America Channel Comments at 1-2. It is not clear, however, that this proposal would provide even a temporary solution for start-up services. In an à la carte system, there presumably would be no packages of well-established services with which such newly launched services could be packaged.

14 *See* ACA Comments at 6-7; *see also* BSPA Comments at 10; EchoStar Comments at 1, 3. Indeed, ACA notes that its members cannot afford the transition to digital services that would be required in order to offer à la carte services. ACA Comments at 48-49. Thus, the voluntary and mixed tiering/à la carte systems proposed by some commenters would risk putting some operators out of business. *See, e.g.*, EchoStar Comments at 3-4; CU/CFA Comments at 7; Center for Creative Voices in Media Comments at 8; Parents Television Council Comments at 3-4.

15 *See* CU/CFA Comments at 2-3; BSPA Comments at 11; CT Communications Comments at 4; The America Channel Comments at 1.

complete package of program services.[16] The package as a whole must be worth at least as much to consumers as the price charged for it; otherwise, they would not subscribe. Indeed, program services, like many other products, are bundled into a single package in order to provide low-cost variety to consumers. In particular, when it costs little for a provider to add variety to a product that some people will like, it is in the best interests of both the distributor and consumers to include such elements, even though they may not appeal to everyone. In such circumstances, it is often far more cost-efficient to provide all consumers with a relatively broad bundle of services than to enable consumers to hand pick individual packages.[17]

To illustrate this point, EI analogizes program tiers to the packaging of crayons.[18] Consumers can purchase crayons in boxes of varying sizes, just as they can choose among the different tiers offered by an MVPD. In each box of crayons, there are colors that a particular consumer will use frequently, and other colors that the consumer rarely or never will use. Yet, the colors are sold in packages so that the vast majority of consumers can get the colors they do want at a relatively low cost. While one consumer may not care to use the periwinkle crayon, for example, it inevitably will be someone else's favorite color. By including that color in a box, the distributor makes the box more appealing to consumers as a whole, even though it may add no value for some consumers.

In addition, consumers may value the option of using new colors in the future.[19] Distributing crayons in boxes gives consumers the opportunity to experiment with new colors

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16 *See* Bruce M. Owen and John M. Gale, Economists Incorporated, *Why a Box of Crayons Has Many Colors and the "Cable Tax" Is Not a Tax*, at 4-5 (August 13, 2004) (Attachment 1) ("EI Response").

17 *Id*. at 4.

18 *See id*. at 3-6.

19 *See* EI Response at 5.

and provides ready access to colors that they may use only on an occasional basis or for which they may have an unexpected need. By contrast, it likely would be considerably more expensive and burdensome to provide each consumer with only the colors that he or she wants at any given time. Such a system could entail, for example, the creation and maintenance of a specialized crayon store, where there would be bins of individual crayons and customers could mix and match colors.[20] Of course, consumers would be required to take a special trip to the store in order to buy crayons and to spend the time to select individual color assortments. They also would need to return to the store every time they had a need for a new color. By the same token, the inclusion of a wide range of program networks into a single package makes MVPD service more valuable and less costly to consumers as a whole, even though some subscribers may not value certain channels within the package.

For these same reasons, the assertion by Consumers Union/Consumer Federation of America that an à la carte option would remove the "cable tax" that subscribers currently pay for unwanted program services is fundamentally flawed.[21] In particular, the notion of a "tax" implies that consumers pay more for a bundle of services than they would pay for only the services they want on an à la carte basis.[22] As demonstrated in the initial comments of Viacom and numerous other parties, the opposite is, in fact, far more likely to be true.[23] Moreover, Consumers Union/Consumer Federation of America erroneously assumes that the only channels that consumers "want" are those that they watch on a regular basis.[24] As described previously,

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[20] *See id*.

[21] *See* CU/CFA Comments at 2-3.

[22] *See* EI Response at 6-7.

[23] *See* Viacom Comments at 21-25; *see also* Section I(A), *infra*.

[24] *See* CU/CFA Comments at 3 (noting that "the average consumer watches about 12-17 channels regularly").

however, subscribers also derive substantial value from the ability to sample new networks and to watch additional services on an occasional basis.[25] In sum, the misleadingly named "voluntary" à la carte proposals should be flatly rejected by both the FCC and Congress as directly contrary to consumer interests.

II. THERE IS NO BASIS FOR ADDITIONAL REGULATORY INTERFERENCE IN RETRANSMISSION CONSENT NEGOTIATIONS

A small handful of commenters contend that broadcasters consistently engage in anticompetitive tactics in the context of retransmission consent negotiations.[26] In particular, these parties attempt to depict broadcasters' willingness to exchange the carriage of affiliated program services for MVPD retransmission consent rights as a blatant and harmful exercise of market power. In actuality, there is nothing inherently anticompetitive about this form of bundling and, as demonstrated by traditional antitrust analysis as well as FCC precedent, the current negotiations between broadcasters and MVPDs are not conducted in an anticompetitive manner. Thus, the long list of changes that these parties seek to make to the existing retransmission consent and program access regimes are wholly unnecessary. Making the drastic changes recommended by these commenters would, moreover, do violence to the competitive objectives Congress sought to achieve in establishing these regulatory regimes.

A. MVPDs Historically Have Offered In-Kind Consideration For Broadcast Carriage

The offering of program services in packages to MVPDs is a longstanding industry practice that began at the insistence of cable operators and that balances the competitive interests of programmers and MVPDs. When the first retransmission consent negotiations were

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25 *See* Viacom Comments at 10.

26 *See* ACA Comments at 3-6, 15; EchoStar Comments at 5-7; CT Communications Comments at 2; Discovery Comments at 26-30; The Pioneer Telephone Association Comments at 5-6 ("Pioneer Telecom Comments").

conducted in the early 1990s, leading cable operators insisted that they would make no cash payments to broadcasters.[27] Eventually, agreements were reached between the broadcast networks and cable operators that provided for the cable operators to carry various new broadcast network-owned cable programming services in return for retransmission consent rights to local TV signals. This arrangement made sense for both parties, as MVPDs were able to obtain broadcast carriage rights at relatively low cost and programmers gained important distribution rights. Since that time, retransmission consent negotiations between broadcasters and MVPDs generally have involved package deals, at the insistence of the MVPD buyers.

Since this practice has become the industry norm, the FCC has endorsed the policies underlying it on several occasions. In establishing guidelines for "good faith negotiations," for example, the Commission deemed "[p]roposals for carriage conditioned on carriage of any other programming, such as . . . an affiliated programming service" as presumptively in good faith and "consistent with competitive marketplace considerations."[28] The agency further noted in this regard that "arbitrarily limit[ing] the range or type of proposals that the parties may raise in the context of retransmission consent will make it more difficult for broadcasters and MVPDs to reach agreement."[29] Similarly, in resolving a retransmission consent dispute between EchoStar and Young Broadcasting in 2001 in Young's favor, the FCC noted that "offering retransmission consent in exchange for … other programming such as a cable channel" is "consistent with competitive marketplace considerations."[30]

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27 *See* Disney Comments at 41, n. 57; *see also id*. at 42, n. 62.

28 *Implementation of the Satellite Home Improvement Act of 1999*; *Retransmission Consent Issues: Good Faith Negotiation and Exclusivity, First Report and Order*, 15 FCC Rcd 5445, 5469-70 (2000).

29 *Id*. at 5469.

30 *EchoStar Satellite Corporation v. Young Broadcasting*, 16 FCC Rcd 15070, 15079 (2001).

As explained below, antitrust analysis shows that there is no basis for altering this longstanding industry practice through regulatory intervention.

B. Existing Bundling Arrangements Are Consistent With Traditional Antitrust Principles

A few comments submitted in this proceeding, most notably EchoStar's, have suggested that seeking carriage of affiliated cable programming as consideration for retransmission consent rights violates the antitrust laws and, on that basis, have urged the Commission to find that such alleged "tying" arrangements violate the retransmission consent/good faith statutory mandate.[31] As discussed below, these commenters have misunderstood, or perhaps misstated, current antitrust jurisprudence and economic thinking on tying and bundling.

The Supreme Court's decision in *Jefferson Parish Hospital District. No. 2 v. Hyde* is the starting point for analyzing tying and bundling arrangements under the antitrust laws.[32] As Justice O'Connor stated in her oft-cited concurrence in *Jefferson Parish*, "a tie has been illegal only if the seller is shown to have sufficient economic power with respect to the tying product to appreciably restrain free competition in the market for the tied product…."[33] This is because there is nothing inherently anticompetitive about tying or bundling. In fact, "[b]uyers often find

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31 *See* EchoStar Comments at 6-7. This Section II(B) assumes *arguendo* that "bundling" retransmission consent and program carriage constitutes "tying." *See Marts v. Xerox, Inc.*, 77 F.3d 1109, 1113 (8th Cir. 1996) (no unlawful tying where products are separately available; plaintiff failed to show that purchasing products together is the only viable economic option); *Amerinet, Inc. v. Xerox Corp.*, 972 F.2d 1483, 1500-01 (8th Cir. 1992) (no tying arrangement when purchaser can take either product by itself, even if seller also offers the products as a unit at a single price). In comments previously submitted to the Commission, however, Disney, Fox, NBC, and Viacom all noted that: "The reality is that the Broadcast Networks offer Cox and other cable operators multiple options for consideration in exchange for retransmission consent, most often a cash payment per subscriber or carriage of affiliated cable programming channels. Whether Cox or any cable operator carries affiliated programming channels or pays cash is the result of its choices made in marketplace negotiations." Reply Comments of Fox Entertainment Group, Inc. and Fox Television Stations, Inc.; National Broadcasting Company, Inc. and Telemundo Communications Group, Inc.; Viacom; and The Walt Disney Company and the ABC Television Network, *Annual Assessment of Competition in the Delivery of Video Programming*, MB Docket No. 03-172, at 2 (Sept. 26, 2003).

32 466 U.S. 2 (1984).

33 *Id*. at 34 (internal citation omitted).

package sales attractive; a seller's decision to offer such packages can merely be an attempt to compete effectively—conduct that is entirely consistent with the Sherman Act."[34] Just this term, the Supreme Court warned the lower courts to be mindful of "false positives" (*i.e.*, mistaken condemnation of procompetitive conduct) in applying the antitrust laws.[35] Specifically, the Court admonished that "[m]istaken inferences and the resulting false condemnations are especially costly, because they chill the very [types of competitive] conduct the antitrust laws are designed to protect."[36] Here, a "false positive" would arise from any presumption that linkage between retransmission consent rights and carriage of affiliated cable programming is anticompetitive.

Relying on *Jefferson Parish*, lower courts now generally require antitrust plaintiffs to prove, *inter alia*, the following elements to state an unlawful tying claim: (1) sufficient economic power in the tying product market to coerce the purchase of the tied product; (2) evidence of actual coercion; and (3) an appreciable effect on competition in the tied market.[37] Under these criteria, an antitrust plaintiff could not establish that the mere linking of retransmission consent with carriage of affiliated cable networks—or the packaging of cable networks—demonstrates an illegal tying arrangement.

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34 *Id*. at 12.

35 *Verizon Comm. Inc. v. Law Offices of Curtis V. Trinko*, 124 S. Ct. 872, 882 (2004).

36 *Id*. (*citing Matsushita Elec. Industrial Co. v. Zenith Radio Corp.*, 475 U.S. 574, 594 (1986)) (internal quotations omitted).

37 *See, e.g., Hack v. President and Fellows of Yale Coll*., 237 F.3d 81, 86 (2d Cir. 2000). In addition, of course, courts must find the existence of a tying and a tied product. *See supra* note 31.

1. Absence of Coercive Power

At least in the absence of MVPD/programmer vertical integration, an individual broadcast network does not have "*sufficient* economic power in the tying market to *coerce* purchaser acceptance of the tied product."[38] Contrary to EchoStar's suggestion, therefore, it is not sufficient for a plaintiff to demonstrate that a network owned station merely possesses *some* degree of market power. It must show that such power is sufficient to coerce acceptance of the tied product. A reviewing court almost certainly would reject any claim that a single network station has coercive market power. This is especially the case in today's robust programming marketplace, which consists not only of broadcast and traditional MVPD services, but also an ever-expanding range of new choices.[39]

In particular, "[c]ourts have consistently refused to consider one brand to be a relevant market of its own when the brand competes with other potential substitutes."[40] Thus, it is preposterous to contend that the broadcast networks don't compete with each other—much like arguing that Coke and Pepsi don't compete as they struggle to achieve the best possible supermarket "shelf space" (and other desirable terms) for the lead product and each of its various subsidiary brands. Indeed, it is likely that an antitrust court would view broadcast networks as

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[38] *Hack v. Yale*, 237 F.3d.at 86 (emphasis added).

[39] In recent decisions, the FCC has observed the increasing competitive pressure that subscription video services have placed on the broadcast networks. *See, e.g.*, *2002 Biennial Regulatory Review—Review of the Commission's Broadcast Ownership Rules and Other Rules Adopted Pursuant to Section 202 of the Telecommunications Act of 1996, Report and Order and Notice of Proposed Rulemaking*, 18 FCC Rcd 13620, 13665-66 (2003) (noting that "[s]ince its inception, non-broadcast programming has gained significantly in popularity as compared with broadcast programming" and that "broadcasters face intense competitive pressure from alternative video programming") ("*2002 Biennial Review Order*").

[40] *Hack v. Yale*, 237 F.3d at 86 (*quoting Little Caesar Enterprises, Inc. v. Smith*, 34 F.Supp.2d 459, 477 n. 30 (E.D. Mich. 1998)); *see also Town Sound and Custom Tops, Inc. v. Chrysler Motors Corp.*, 959 F.2d 468, 480 (3d Cir. 1992) ("Except in rare circumstances, courts reject market definitions consisting of one supplier's products where other brands compete.").

part of a larger market that includes all cable channels, at least those channels that are advertiser-supported.

Moreover, EchoStar's reliance on the FCC's recent *News Corp./DIRECTV* decision as support for its broad-based antitrust arguments is inapposite.[41] Significantly, in that case, the agency did not find that a non-vertically integrated network station owner possessed the power to coerce carriage. Indeed, it found that the relative bargaining positions of broadcasters and MVPDs generally were in equipoise:

> Both programmer and MVPD benefit when carriage is arranged: the station benefits from carriage because its programming and advertising will likely reach more households when carried by MVPDs than otherwise, and the MVPDs benefit because the station's programming adds to the attraction of the MVPD subscription to consumers. Thus, the local television broadcaster and the MVPD negotiate in the context of a roughly even 'balance of terror' in which the failure to resolve local broadcast carriage disputes through the retransmission consent process potentially *damages each side greatly* in their core business endeavor.[42]

Rather than finding that there was any existing imbalance in the retransmission consent negotiations, the *News Corp./DIRECTV* decision focused on the shift in bargaining power that could result from the proposed vertical integration of an MVPD and a broadcaster.[43] Chairman Powell underscored in his separate statement that the Commission's action was based solely on

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[41] *General Motors Corporation and Hughes Electronics Corporation, Transferors And The News Corporation Limited, Transferee, For Authority to Transfer Control, Memorandum Opinion and Order*, 19 FCC Rcd 473, 555-57 (2004) ("*News Corp./DIRECTV*").

[42] *Id.* at 556 (emphasis added).

[43] *See id.* at 568 (concluding that "the transaction will increase News Corp.'s post-transaction incentive and ability to temporarily withhold access to the signals of its television broadcast stations as a negotiating tactic by lowering the risks of and costs to News Corp. of engaging in such foreclosure"); *see also* EI Response at 10-14. Accordingly, the agency's decision to take remedial action was necessitated only when "News Corp.'s acquisition of DIRECTV" threatened to substantially disrupt this balance. *Id.* at 565.

"merger-specific harm[s]" relating to the transaction at issue.[44] Thus, in the absence of such vertical integration, it is abundantly clear that individual networks lack the requisite level of economic power to coerce MVPDs.

This conclusion is consistent with the outcome one would expect in a straightforward antitrust analysis of these facts and circumstances. Under any reasonable approach to market definition, none of the broadcast networks would be deemed to have a market share in excess of 30 percent. And since *Jefferson Parish*, "no court has inferred the requisite market power [to state a tying claim] from a market share below 30 percent."[45]

2. Absence of Actual Coercion

In light of the "roughly even 'balance of terror'" that characterizes the positions of MVPDs and programmers, it is evident that neither side has coercive power over the other. Given the absence of such power, it is an *a fortiori* proposition that neither party is in a position to demonstrate the *actual exercise* of coercive power by the other.

But this is not merely a theoretical proposition. Its validity is borne out in the results of real world, head-to-head negotiations. Last year's well-publicized contract negotiations between EchoStar and Viacom provide an excellent illustration that the current system works. In those negotiations, Viacom sought to have EchoStar carry more programming services and give those services broader distribution, while EchoStar negotiated to carry fewer channels and place them on different tiers. In the end, EchoStar's CEO acknowledged that his company had successfully

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44 *News Corp./DIRECTV* (Separate Statement of Chairman Michael K. Powell, at n. 2).

45 ABA Section of Antitrust Law, *Antitrust Law Developments*, at 196 and cases cited therein at n. 1111 (5th ed. 2002).

negotiated a deal that was “good enough” for both parties[46]—demonstrating, once again, that these private contract disputes involve parties who are quite clearly capable of looking out for their own interests without governmental intervention, and that the “balance of terror” leads to just the kind of open market resolution that tough bargaining and tough competition encourages.[47]

More generally, Viacom simply does not “force” MVPDs to carry any of its program services. Despite the handful of claims to the contrary,[48] all MVPDs are, in fact, free to buy none, one, several, or all of Viacom’s services. As demonstrated by the EI study submitted with Viacom’s opening comments, for example, *no* cable system offers *all* of Viacom’s program services, and only 13 percent of the systems studied took 75 percent or more.[49] In addition, more than one-quarter of cable systems currently carry some, but not all, of MTV Networks’ traditional analog services. When the top six cable operators are excluded from the pool, moreover, that number nearly doubles. Thus, about half of the country’s smaller operators decline to take all of the MTV Networks basic analog services. Of these systems, six percent have chosen to buy Nickelodeon and *not* MTV, while seven percent have chosen to buy

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[46] *See, e.g.*, John M. Higgins, *The Blackout Backfired*, Broadcasting & Cable (March 15, 2004); *see also* EchoStar Communications, Call to Discuss Viacom Agreement at 5-6 (March 11, 2004), available at www.callstreet.com/call_schedule.asp?eventid=21816.

[47] This balance is a factor not just in broadcasters’ carriage negotiations with the largest multi-system operators, but also in their dealings with smaller MVPDs. It is critical for Viacom and other broadcasters to have their services viewed by as broad an audience as possible, and overall, small operators provide service to a substantial portion of U.S. viewers. Furthermore, many small MVPDs operate in rural areas where over-the-air reception is unavailable and MVPD services provide the only means to view both broadcast and subscription programming. In such areas, achieving MVPD carriage takes on even greater importance.

[48] *See* ACA Comments at 3; EchoStar Comments at 3; CT Communications Comments at 2.

[49] *See* Viacom Comments at 10-11; *see also id.*, Attachment 1 (Bruce M. Owen and John M. Gale, Economists Incorporated, *Cable Networks: Bundling, Unbundling, and the Costs of Intervention*, at 16-19).

Nickelodeon and *not* SPIKE TV. Thus, real-world evidence flatly contradicts claims that cable operators and other MVPDs are given no legitimate choice but to carry all Viacom services.

3. Absence of Anticompetitive Effects

In addition, it is unlikely that a court would find that linking retransmission consent rights to carriage of affiliated cable programming would have an appreciable effect on competition in a putative tied market (*i.e.*, cable programming). Indeed, in light of the abundance of channels MVPDs are now able to offer their subscribers, retransmission consent negotiations that result in the carriage of one or more affiliated program services simply cannot have a significant impact on today's incredibly robust and highly competitive program marketplace.[50] In sum, bundling retransmission consent with the carriage of cable program services is consistent with competitive marketplace considerations and should continue, as explained next, without further regulatory intervention.

C. The Specific Requests For Intervention In Retransmission Consent Negotiations Are Wholly Unnecessary And Would Undermine Important And Longstanding Congressional Objectives

The handful of commenters who have expressed grievances with the retransmission consent process have requested a laundry list of changes to the congressionally mandated retransmission consent scheme, which would impose onerous burdens on over-the-air broadcasters.[51] As discussed above, these changes are not needed to correct any competitive imbalance. Moreover, these efforts to restrict or eliminate local broadcasters' retransmission consent rights would eviscerate the competitive objectives that Congress and the Commission sought to achieve in establishing and implementing the retransmission consent regime. In

[50] *See, e.g., 2002 Biennial Review Order*, 18 FCC Rcd at 13634 (noting that consumers are now "served by literally hundreds of networks serving all conceivable interests"); *see also* Viacom Comments at 6-8.

[51] *See* ACA Comments at 16-17; EchoStar Comments at 4-7; CT Communications Comments at 11.

particular, such regulatory intervention would threaten the congressional goal of ensuring the continued viability of free, over-the-air broadcasting.

Aside from alarmist rhetoric, these commenters provide no basis for the Commission to recommend such far-reaching regulatory measures. The speculative allegations made by these parties are devoid of specific examples, and they provide no economic analysis in support of their claims. Moreover, to the extent that an MVPD may believe that an individual broadcaster has acted in bad faith in the context of retransmission consent negotiations, there already is a comprehensive complaint process in place at the FCC to resolve such concerns and to provide the aggrieved distributor with a remedy.[52] No commenter to this proceeding has suggested that this complaint process is in any way insufficient to deal with specific instances of bad faith negotiations.[53]

In essence, these few commenters seek to deprive broadcasters of the right to be fairly compensated for the carriage of their local signals and, thereby, to regress to the unbalanced environment that existed prior to the enactment of the retransmission consent statute. For decades, the Communications Act granted broadcasters no right to control the use of their signals by MVPDs, which were free to carry local broadcast signals without "having to compensate the broadcaster for the value its product create[d]" for them.[54] By 1992, however, Congress realized

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52 *See* 47 C.F.R. § 76.7.

53 Several parties to this proceeding ask the FCC to require programmers to disclose the prices, terms, and conditions of their carriage agreements. *See* ACA Comments at 8-9; CT Communications Comments at 2, 9; Public Cable Television Authority Comments at 1-2 (July 12, 2004). As EI explains, such a requirement is both unnecessary and actually could reduce competition. *See* EI Response at 7-8. Non-disclosure contract provisions are commonplace in the U.S. economy. Moreover, in some circumstances, revealing information about wholesale prices to competitors has been viewed as anticompetitive and conducive to the formation or stability of cartels. In the context of carriage negotiations, MVPDs benefit substantially from the fact that programmers do not know the amount that operators have paid for competing networks.

54 S. Rep. No. 102-92, at 35 (1991), reprinted in 1992 U.S.C.C.A.N. 1133, 1168. While the Communications Act precluded a broadcast station from "rebroadcast[ing] the program or any part thereof of another broadcasting

that this inability of broadcasters to control the use of their signals created a "distortion in the marketplace which threaten[ed] the future of over-the-air broadcasting."[55] Congress specifically recognized that "a very substantial portion of the fees which consumers pay to cable systems is attributable to the value they receive from watching broadcast signals" and that the law should not endorse a system "under which broadcasters in effect subsidize the establishment of their chief competitors."[56]

To address this marketplace distortion, Congress enacted an overall regime establishing and defining the circumstances under which cable operators could obtain the right to retransmit broadcast signals.[57] Under this "retransmission consent" regime, MVPDs must obtain "express authority" from a station before retransmitting its signal, and broadcasters have the ability to seek just compensation in exchange for such carriage rights.[58] In passing this legislation, Congress was careful to note that its "intention [was] to establish a marketplace for the disposition of the rights to retransmit broadcast signals," and not "to dictate the outcome of the ensuing marketplace negotiations."[59] Moreover, Congress specifically anticipated that the

station without the express authority of the originating station," 47 U.S.C. § 325(a), the FCC concluded this statutory prohibition did not extend to cable operators. *CATV and TV Repeater Services*, Report and Order, 26 F.C.C. 403 (1959).

55 S. Rep. No. 102-92, at 35, 1992 U.S.C.C.A.N. at 1168.

56 *Id*.

57 Congress expected that broadcasters would utilize this newly created right to obtain compensation (*e.g.*, cash or the carriage of other program services) in exchange for grants of retransmission consent and therefore would be better able to compete in the video marketplace. *Id*. at 35-36, 1992 U.S.C.C.A.N. at 1168-69.

58 47 U.S.C. § 325(a).

59 S. Rep. No. 102-92, at 36, 1992 U.S.C.C.A.N. at 1169.

consideration paid by a cable operator in exchange for carriage of a local signal could be "the right to program an additional channel on a cable system."[60]

In addition to their requests to essentially do away with the retransmission consent rules, several parties ask the FCC to further weaken broadcasters' rights to negotiate for carriage of their local signals by reciting their typical requests to expand the program access rules to non-vertically integrated programmers, including broadcasters.[61] Like the retransmission consent laws, the program access rules enacted by Congress in 1992 were targeted at a specific marketplace imbalance—the ability of cable operators and programmers *vertically integrated* with cable operators to impede the development of nonaffiliated cable operators and competitive MVPDs.[62] In creating the program access protections, Congress specifically observed that "vertically integrated program suppliers have the incentive and ability to favor their affiliated cable operators over other multichannel programming distributors."[63] Although parties repeatedly have asked the agency to expand the scope of the program access rules to non-vertically integrated programmers, the Commission consistently has rejected such requests as

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60 *Id.* In addition, in 1999, Congress granted DBS operators a copyright license to make secondary transmissions of a broadcast station's signal into the station's local market through the adoption of the Satellite Home Viewer Improvement Act of 1999. Pub. L. No. 106-113, 113 Stat. 1501, Appendix I (1999).

61 S*ee* ACA Comments at 18-19; CT Communications Comments at 11; EchoStar Comments at 7-8.

62 *Implementation of the Cable Television and Consumer Protection and Competition Act of 1992*, 17 FCC Rcd 12124, 12158 (2002).

63 *Implementation of Sections 12 and 19 of the Cable Television Consumer Protection and Competition Act of 1992*, 8 FCC Rcd 3359, 3366 (1993). Moreover, while the program access provisions prohibit vertically integrated satellite program providers from engaging in various forms of price discrimination, Congress specifically permitted these cable-affiliated entities to offer MVPDs "different prices, terms, and conditions that take into account economies of scale, cost savings, or other direct and legitimate economic benefits reasonably attributable to the number of subscribers served by the distributor." 47 U.S.C. § 548(c)(2)(B)(iii); *see also Implementation of Sections 12 and 19 of the Cable Television Consumer Protection and Competition Act of 1992*, 8 FCC Rcd at 3407. The calls by some commenters to eliminate the right of programmers to offer such volume discounts are unsupported by economic analysis and ignore the fact that such discounts are commonplace in economic transactions. *See* Pioneer Telecom Comments at 8-9; National Telecommunications Cooperative Association Comments at 4-5.

contrary to both the language of the statute and, more importantly, to Congress' intent to "limit[] the program access provisions to a specific group of market participants."[64] No party to this proceeding provides any basis for the FCC to abandon its consistent position on this issue.

In sum, by calling for broadcasters' retransmission consent rights to be dismantled, these commenters are transparently seeking to do little more than advance their individual bargaining power by denying broadcasters the rights that they would have in a competitive atmosphere to seek fair compensation for their services. In so doing, these parties would upset the careful balance struck by Congress in establishing both the retransmission consent and program access regimes. In particular, they would undo the measures that Congress took to ensure the continued viability of free, over-the-air broadcasting in today's increasingly subscription-oriented video programming environment. No changes have occurred since these laws were passed to warrant such a far-reaching shift in Congress' and the FCC's public interest objectives.

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64 *Implementation of the Cable Television and Consumer Protection and Competition Act of 1992*, 17 FCC Rcd at 12158.

III. CONCLUSION

Viacom submits that the FCC should report to Congress that a mandatory à la carte or themed tiering regime would be harmful to both industry participants and consumers. The FCC further should clarify that imposing increased regulatory burdens on the retransmission consent process would be unnecessarily onerous and, thus, detrimental to the public interest.

Respectfully submitted,

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ATTACHMENT 1

Why A Box of Crayons Has Many Colors, and the "Cable Tax" is not a tax

Why Contract Confidentiality Promotes Competition

and

Why the *News Corp* Retransmission Consent Conditions Don't Apply to Other Broadcast Networks

by

Bruce M. Owen and John M. Gale

August 13, 2004

Economists Incorporated

Washington DC

Why A Box Of Crayons Has Many Colors, And The "Cable Tax" Is Not A Tax

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Why The News Corp Retransmission Consent Conditions Don't Apply To Other Broadcast Networks

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Bruce M. Owen and John M. Gale[†]

Summary

Viacom asked us to provide economic analysis of certain issues raised by first round filings in this proceeding. In this brief paper, we reiterate our point that bundling is, in general, a practice highly beneficial to consumers and to competition. We also point out that economic theory does not, as has been insinuated, condemn as inherently suspect all instances of product bundling. Further, the argument that MVPD subscribers are being "taxed" for programming they "do not want" makes no economic sense.

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We also examine two issues raised by the American Cable Association. First, we demonstrate that the forcible public disclosure of confidential terms of contracts between program suppliers and MVPDs could readily have the effect of reducing competition. Second, we point out that the Commission's conditions regarding retransmission consent negotiations placed on News Corp. when it acquired DirecTV were related to the economic structure of that specific transaction; they make no sense applied to other, non-vertically-integrated, broadcast networks.

Why A Box of Crayons Has Many Colors

It simply cannot be true, as a matter of common sense, that there is a grave economic inefficiency associated with every product that we purchase, owing to its being made up of various parts. As we pointed out in our earlier paper in this proceeding, virtually all goods and services are bundled at the time of sale.[1] Very often, perhaps most often, the parts of the bundle are not available separately, or would cost more than the price of the bundle if supplied separately.

Nevertheless, some commentators in this proceeding on à la carte cable pricing have asked, "Why should I have to pay for channels I never watch?" The short answer is that they are not paying for them, they are paying for a complete package. The package as a whole is worth more than the price; otherwise they would not subscribe. The long answer requires explaining some basic economic concepts about how bundling a variety of elements into a single sale benefits both the seller and the buyer.

Many products are bundled because the bundling service itself is highly valuable to consumers, as with the purchase of an automobile. Many other products are bundled together into a single sale in order to provide variety to buyers at low cost. For this type of product, consumers would like to have a variety of different types of the product offered as a single purchase. An analogy, though not an exact one, can be drawn between cable networks and crayons. Consumers can choose among 8, 16, 64, or (the coveted) 96 crayon boxes, just as they can choose among the various tiers offered by an MVPD. In each of the boxes there are col-

[1] Bruce Owen and John Gale, *Cable Networks: Bundling, Unbundling, and the Costs of Intervention*, July 15, 2004, submitted with Viacom's initial comments in the matter of À La Carte and Themed Tier Programming and Pricing Options for Programming Distribution on Cable Television and Direct Broadcast Satellite Systems, FCC Docket No. MB-04-207 (July 15, 2004).

ors that a particular consumer likes and uses often and colors that he will likely never use. One could ask the same question about crayons as about cable networks: "Why should I be forced to pay for crayons that I don't like and will never use?" Why shouldn't regulators require that crayons be unbundled so that consumers can buy only the colors they like?

The answer is the same for both crayons and cable networks, though the intuition behind it may be clearer for crayons. For products where it costs little (or nothing) for a provider to include more variety that *someone* may like, it is in the best interests of the seller and the buyer to include elements that not *everyone* wants. One consumer may not care to use the periwinkle crayon, but that is someone else's favorite color, so it is included in the box to please the second person and get him to buy a box. A maker of crayons knows that some colors are popular and some are not-so-popular. To make as many sales as he can, the crayon maker will include the popular colors in more boxes and will also include the not-so-popular colors in some boxes to induce the odd-color-lovers to buy a box of crayons. A color may be included only in the largest box if it appeals to few people, even though it is especially important to those people. In this way the seller makes the complete box more valuable to consumers as a whole, even though it may not make it more valuable to a particular consumer. Finally, it has to be the case that each buyer values the box of crayons he chooses to buy more than the price he pays, even though he may not value a particular color at all. Similarly, removing a particular color from the box because a buyer does not intend to use it would not change the price charged for the box of crayons. The same price is charged to all buyers, whether they use only one color or every color in the box.

In the same way, an MVPD will offer the most popular channels in most packages (or tiers) while also including some specialty or niche channels. By including more channels, the entire package is more valuable to potential cable subscribers on average, so the cable system sells more subscriptions. At the same time, a particular subscriber may not find that the additional channels make the package more valuable to her. It is always true that each subscriber values the entire package more than the price she pays *or she would not choose to subscribe.*

It may seem wasteful for a seller to give people crayons (or channels) that they do not use, but in fact, it can be more costly to provide only the specific colors each buyer wants. For crayons, one could imagine a specialized crayon store with bins of each color crayon where a buyer could mix and match whatever colors he wants. Of course, this would require the creation of the specialized crayon store and a trip by each consumer to the store. In the case of MVPDs, this would require each consumer to have a set-top box for each television and to have good information about the programming on every network offered by the cable system. It is likely more efficient to give a buyer some crayons he does not use (or a subscriber channels she does not watch) than to mandate a system where each buyer only gets the colors he likes (or the channels she watches).

An additional feature shared by crayons and MVPD services is that although consumers buy crayons and channels that they never use, they may value the option of using that color or channel in the future. Crayon purchasers often do not know which colors will be right for some future project, and value the option to experiment. Even the consumer who does not like periwinkle and would not buy a periwinkle crayon if it were sold separately, may have an occasion in the future where he has to use periwinkle to make a picture. Even though that event may be unlikely, he still values the option of using the color. Similarly, there are channels included in a cable subscription that a consumer has never watched, but there may be a day when that channel carries a show she wants to see. Because of this, even if she never watches a channel it can still be of some value to her. Of course, it is even easier to see that consumers value crayons or networks that they do use, albeit infrequently, even if they would not choose that crayon or network if sold separately.

A final feature shared by crayons and MVPD service is that consumers may not be able to predict accurately what colors or channels they will like when they make their initial purchase. A consumer may not have a good idea of whether he will use a cyan crayon (in fact, he may not even know what cyan looks like), so he cannot make an informed decision about whether to buy a cyan crayon. After using his box of crayons, he realizes that he loves cyan and uses it all the time, which makes his box of crayons more valuable than he had expected. If cyan had not been included in his box, he would never have known how much he liked it. Similarly, every subscriber's cable package includes channels she would probably not have chosen. But the history of cable television programming is replete with examples of shows carried on obscure cable channels that become very popular. In these instances there have to be consumers who would not have chosen the channel but, after sampling a particular show, are very happy to have the channel in their package.

While it is true that bundling benefits consumers overall, admittedly it can make some consumers worse off. To return to the example, if a consumer wants a blue crayon, and only a blue crayon—and will never use any color but blue—then depending on the cost of providing that choice it can be cheaper for that one consumer if crayons are not bundled. That consumer would be able to buy a box with only a blue crayon, while consumers who prefer a variety of colors would have to select and pay for each individual color. While a consumer with very narrow tastes may be worse off, bundling makes consumers with broad tastes better off because they pay a lower price than if they had to select and purchase each crayon or network individually. As shown in our initial comments, consumers are likely to pay more for the programming they receive if channels were unbundled. Hence, consumers as a whole would be worse off if bundling were prohibited.

On a closely related point, Consumers Union and Consumer Federation of America (CU/CFA) have introduced a new and highly misleading term into the discussion. They maintain that cable subscribers pay a “cable tax.”[2] This tax allegedly consists of the payment that consumers make for programming they don’t want but which they must purchase in order to get the programming they do want. This term is misleading for at least two reasons.

First, CU/CFA seem to include among the channels that consumers “want” only the channels that they watch “regularly,” estimated to be 12-17 channels on average. As we pointed out in our initial comments, consumers who subscribe to a large tier of channels also derive benefits from the channels that they do not view regularly. These consumers are able to tune to channels outside their “regular” channels to watch attractive shows on an occasional basis. They are also able to browse the other channels to determine at low cost whether they would be of interest. Actual behavior shows that consumers value these options and take advantage of them.

Second, the notion of a “tax” implies that consumers pay more for the bundle of programs that includes some channels that are not of interest than they would pay to receive the channels of interest on an à la carte basis. Our initial comments showed that if networks were widely distributed on an à la carte basis, consumers buying a significant number of networks, such as ten, could well end up paying more for those channels than they currently pay for a tier that includes a much larger collection of networks. It is a strange tax that leaves people better off if they pay it than if they don’t.

CU/CFA also submitted a paper by sociologist Dr. Mark Cooper, noting that “the possibility of anti-consumer bundling has long been recognized in static consumer welfare economics literature.”[3] Dr. Cooper cites three economic articles

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2 *Comments of Consumers Union and Consumer Federation of America*, July 15, 2004, at 3.

3 Mark Cooper, *Time to Give Consumers Real Cable Choices*, July 2004, at 5.

in support of this statement.[4] These papers consider bundling in circumstances that eliminate many of the potential advantages of bundling from being considered. For example, they assume that bundling is strictly a pricing practice, and that consumers derive no utility from the assembly of the bundle on their behalf. They assume that bundles do not cost less to produce and market than their components would. They also assume that each component of the bundle could viably exist as a stand-alone "product;" that is, they do not consider the vast class of components that are efficiently supplied only as "parts." Dr. Cooper is correct that there is the *possibility* of adverse effects from bundling under certain assumptions, but he does not show, and there is no reason to believe, that MVPD bundling satisfies these assumptions. If Dr. Cooper believes that the situations studied in the theoretical papers he cites are applicable to network programming supplied by MVPDs, he must make that case with appropriate evidence. It is absurd to suggest that every bundled product is guilty of causing consumer harm until proven innocent.

Disclosure of Contract Terms

The American Cable Association (ACA) argues that the Commission should encourage or require programmers such as Viacom to waive non-disclosure provisions in their contracts with MVPDs, so as to make public the information in those contracts.[5]

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[4] William J. Adams and Janet L. Yellen, "Commodity Bundling and the Burden of Monopoly," *Quarterly Journal of Economics*, (1976), 475-98; Richard Schmalensee, "Gaussian Demand and Commodity Bundling," *Journal of Business*, (1984), 211-30; and R. P. McAfee, John McMillan, and Michael D. Whinston, "Multi-product monopoly, commodity bundling, and correlation of values," *Quarterly Journal of Economics*, (1989), 371-83.

[5] American Cable Association, *Comments*, July 12, 2004, at 8.

Non-disclosure provisions in contracts are commonplace throughout the U.S. economy. Wholesale contracts with major retailers such as Wal-Mart and Toys "R" Us, for example, are not public knowledge, even though these companies are reported to negotiate very favorable terms. Distributors of carbonated beverages have different deals with supermarkets, liquor stores, convenience stores, drug stores, and other businesses, at different prices, but these contracts are not public. ACA's cable operator members probably negotiate rates with advertisers who buy time from them but do not disclose to one advertiser what another advertiser pays.

Making information about prices available to competitors, in some circumstances, has been seen as anticompetitive. For example, price verification calls made by corrugated container suppliers were part of a pattern that the Supreme Court held to be per se unlawful.[6] Such public dissemination is generally seen as conducive to the formation or stability of cartels. In negotiation with a network, it is a benefit to cable operators that the network does not know exactly what fees the operator has agreed to with competing networks. Requiring filing and public disclosure of prices is of course commonplace in regulated industries where the principal purpose of the regulatory authority is to stifle competition. The ICC, before it was abolished, made secret rebates or discounts from public tariffs unlawful, in order to keep motor carrier rates high. Obviously, this did not benefit shippers. The same system applied to railroads, airlines, and other industries. Most observers believe that consumers gained considerably from the deregulation of these industries.

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6 *United States v. Container Corp.* 393 U.S. 333 (1968). For a general discussion of information exchanges and their effects on competition, see Dennis W. Carlton and Jeffrey M. Perloff, *Modern Industrial Organization*, 3rd Edition, Chapter 5.

Retransmission Consent

ACA also noted that the Commission recently placed restrictions on the way News Corp. could negotiate retransmission consent agreements, as a condition of its approval of News Corp's acquisition of DirecTV.[7] ACA's comments give the impression that the same factors relevant in that matter apply generally to all networks negotiating the sale of retransmission rights and that the additional restrictions placed on News Corp. should be extended to all retransmission consent negotiations.[8]

That impression is not correct, for good economic reasons. The conditions in the News Corp. case were specific to that case, which involved vertical integration between News Corp. and an MVPD (DirecTV). None of the other three major broadcast network owners, Viacom, Disney and General Electric, is vertically integrated with an MVPD. Therefore, the Commission's concern that vertical integration with an MVPD would allow News Corp. to use retransmission consent to harm competition and consumers does not apply to the other major broadcast networks.

When a broadcast television station opts for retransmission consent instead of must-carry, it bargains with MVPDs for compensation in exchange for the right to retransmit its broadcast signal. The FCC has previously pointed out that the conflicting goals of broadcast station owners and MVPDs in retransmission consent negotiations leads to a "balance of terror." Both sides are offering something valuable: the broadcaster is offering content that makes the MVPD's

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7 *In the Matter of General Motors Corporation and Hughes Electronic Corporation, Transferors and The News Corporation Limited, Transferee, For Authority to Transfer Control*, MB Docket No. 03-124, Memorandum and Order (released January 14, 2004) ("*News Corp. Order*").

8 American Cable Association, *Comments*, July 12, 2004, at 16-18, 30-31.

product more attractive to subscribers and the MVPD is offering carriage that allows the broadcaster to reach more viewers. Each negotiates to keep as much as possible of the excess value for itself. This negotiation results in a price that balances the costs and benefits to the broadcaster and the MVPD. The Commission put it as follows:

> Although the bargaining may encompass many issues, it is ultimately about the 'price' an MVPD is willing to pay for carriage of the local broadcast station, and although that price may be in the form of monetary compensation, it is more likely to be structured in the form of an 'in kind' payment whereby the MVPD provides channel capacity for a broadcast network's affiliated cable programming network and/or other carriage-related concessions. … Both programmer and MVPD benefit when carriage is arranged: the station benefits from carriage because its programming and advertising will likely reach more households when carried by MVPDs than otherwise, and the MVPDs benefit because the station's programming adds to the attraction of the MVPD subscription to consumers. Thus, the local television broadcaster and the MVPD negotiate in the context of a roughly even "balance of terror" in which the failure to resolve local broadcast carriage disputes through the retransmission consent process potentially damages each side greatly in their core business endeavor. (*News Corp. Order* ¶ 180, footnotes omitted)

The "balance of terror" may be altered, however, if some costs or benefits can be realized in other ways, as, for example, when one side of the negotiation is vertically integrated with a competitor of the other side. In theory, a broadcast station owner that is integrated with an MVPD that competes for subscribers with the negotiating MVPD would take into account any competitive benefits to its own MVPD if the negotiations were to break down. Some economic models show that a downstream firm (MVPD) may be able to exploit vertical integration with an upstream firm (programming supplier or broadcast network) and deny upstream supply to downstream rivals, depending on circumstances.[9] By denying or raising the price of programming, the integrated MVPD may be able to reduce the effectiveness of the competition it faces. In contrast, a non-integrated broadcaster can only benefit from withholding retransmission consent if it subsequently receives a higher price for its content. The interim lack of valuable programming may harm the MVPD, but it also deprives the station of fees or other benefits and provides no benefit to the non-integrated broadcaster.

The portion of the *News Corp. Order* dealing with retransmission consent focused on the problems that might be created if the Fox Owned and Operated broadcast stations were vertically integrated with DirecTV, not with retransmission consent problems in general. For example, during the Commission's investigation leading up to the *News Corp. Order*, some MVPDs contended "the transaction fundamentally shifts the balance of power between MVPDs and Fox broadcast stations in retransmission negotiations because Fox will have the option to walk away from retransmission consent negotiations and broadcast only on DirecTV." (*News Corp. Order* ¶ 184)

In its comments in the News Corp. proceeding, the American Cable Association contended that threats to deny carriage "will particularly disadvantage

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9 See Janusz Ordover, Garth Saloner, and Steven Salop, "Equilibrium Vertical Foreclosure," *American Economic Review*, March 1990, 80(1), pages 127-142; Oliver Hart and Jean Tirole, "Vertical Integration and Market Foreclosure," *Brookings Papers: Microeconomics*, 1990, pages 205-286; Michael A. Salinger, "Vertical Mergers and Market Foreclosure," *Quarterly Journal of Economics*, May 1988, 103(2), pages 345-56; and Christopher M. Snyder, "Empirical Studies of Vertical Foreclosure," in Bob Hawkins, editor, *1995 Industry Economics Conference Papers and Proceedings* Report 95/23 (Canberra: Australian Government Publishing Service, 1995), pages 98-125 and page 107.

DirecTV's smaller competitors in less dense areas of the country once News Corp. acquires control of DirecTV." (*News Corp. Order* ¶ 186) Various parties argued that the Commission's rule that broadcasters negotiate in good faith was an inadequate safeguard in the context of the proposed transaction since "at the time the good faith provisions were adopted, cross-ownership of a cable system and a television broadcast station in the same market was prohibited, so the Commission was unlikely to have considered the impact of common ownership of broadcast stations and an MVPD on retransmission consent negotiations." (*News Corp. Order* ¶ 188, footnote omitted)

Further, the focus of the News Corp. investigation was not on any existing imbalance in the negotiation for retransmission rights, but on a possible *change* in the balance. The Commission focused on whether the proposed transaction *increased* News Corp.'s incentive and ability to withhold the signals of its owned and operated broadcast stations by lowering the costs to News Corp. of employing such bargaining tactics. "Key to determining the degree to which the transaction lowers News Corp.'s costs of engaging in temporary foreclosure is the number of subscribers that can be predicted to shift from the affected MVPD to competitor DirecTV to access the foreclosed programming, which in turn will increase the profits of the post-transaction company as a whole." (*News Corp. Order* ¶ 204) The Commission determined "that the subscriber shifts required for temporary foreclosure to be profitable are likely to be realized." (*News Corp. Order* ¶ 206, footnote omitted)

The Commission concluded "that the transaction will *increase* News Corp.'s post-transaction incentive and ability to temporarily withhold access to the signals of its television broadcast stations as a negotiating tactic by lowering the risks and costs to News Corp. of engaging in such foreclosure. … [T]his *enhanced* incentive and ability to engage in temporary foreclosure will allow News Corp. to extract more compensation for its broadcast station signals from competing MVPDs than it could reasonably expect to achieve absent the transaction. The potential public interest harms that would result from such a strategy are substantial." (*News Corp. Order* ¶ 209, emphasis added)

Therefore, the *News Corp. Order* does not support ACA's claim that there is an imbalance in the current retransmission consent laws and that additional restrictions need to be placed on the other broadcast networks. Indeed, as Chairman Powell stated,

> One should not view [the Commission's] conditions regarding retransmission agreements or regional sports networks as anything other than a condition to mitigate a merger-specific harm identified in the record of this proceeding. It, especially, should not be interpreted as an industry-wide declaration of the Commission concerning the ongoing commercial disputes between MVPDs and broadcasters or regional and national sports programming networks. (*News Corp. Order*, Separate Statement of Chairman Michael K. Powell, footnote 2)